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2007 MAR 16 P 2:20

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IN THE MATTER OF THE APPLICATION OF
BLACK MOUNTAIN GAS COMPANY AND
SEMSTREAM ARIZONA PROPANE, L.L.C. FOR
APPROVAL OF THE TRANSFER OF THE BLACK
MOUNTAIN PAGE DIVISION AND RELATED
ASSETS TO SEMSTREAM ARIZONA PROPANE
L.L.C.

DOCKET NO. G-03703A-06-0694

DOCKET NO. G-20471A-06-0694

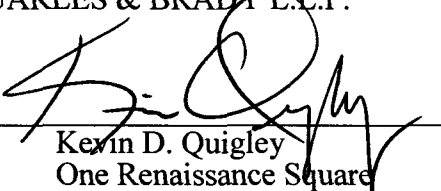
**NOTICE OF FILING OF JOINT
RESPONSE TO STAFF REPORT**

(Assigned to the Hon. Teena Wolfe,
Administrative Law Judge)

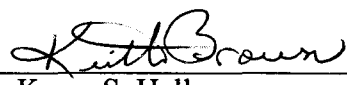
SemStream Arizona Propane, L.L.C. and Black Mountain Gas Company, through undersigned counsel and pursuant to the Commission's Procedural Order dated January 22, 2007, hereby file the attached Joint Response to the Utilities Division Staff Report in the above-captioned matter.

RESPECTFULLY SUBMITTED this 16th day of March 2007.

QUARLES & BRADY L.L.P.

By 
Kevin D. Quigley
One Renaissance Square
Two North Central Avenue
Phoenix, Arizona 85004-2391
Attorneys for SemStream Arizona
Propane, L.L.C.

BLACK MOUNTAIN GAS COMPANY

By 
Karen S. Haller
Keith Brown
5421 Spring Mountain Road
Las Vegas, Nevada 89150-0002
Attorneys for Black Mountain Gas
Company

Arizona Corporation Commission
DOCKETED

MAR 16 2007



Original and fifteen copies filed this
16th day of March, 2007, with:

Docket Control
Arizona Corporation Commission
1200 West Washington
Phoenix, Arizona 85007

Copies of the foregoing hand-delivered
this 16th day of March, 2007, to:

Hon. Teena Wolfe
Administrative Law Judge
Hearing Division
Arizona Corporation Commission
1200 West Washington Street
Phoenix, Arizona 85007

Maureen Scott, Legal Division
Arizona Corporation Commission
1200 West Washington Street
Phoenix, Arizona 85007

Bob Gray, Utilities Division
Arizona Corporation Commission
1200 West Washington Street
Phoenix, Arizona 85007

Alexander Ibhide Igwe, Utilities Division
Arizona Corporation Commission
1200 West Washington Street
Phoenix, Arizona 85007



BEFORE THE ARIZONA CORPORATION COMMISSION

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IN THE MATTER OF THE APPLICATION OF
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DOCKET NO. G-03703A-06-0694

DOCKET NO. G-20471A-06-0694

JOINT RESPONSE

BY SEMSTREAM ARIZONA PROPANE L.L.C.

AND BLACK MOUNTAIN GAS COMPANY

TO

UTILITIES DIVISION STAFF REPORT

DATED MARCH 5, 2007

MARCH 16, 2007

I. INTRODUCTION

Pursuant to the Commission's Procedural Order dated January 22, 2007, SemStream Arizona Propane, L.L.C. ("SemStream Arizona") and Black Mountain Gas Company ("BMG") (collectively the "Applicants") submit this Joint Response to the Utilities Division Staff Report in this docket dated March 5, 2007 ("Staff Report"). BMG, a subsidiary of Southwest Gas Corporation ("Southwest" or "SWG") operates a regulated propane distribution system in and near the City of Page, Arizona (the "Page Division") pursuant to a Certificate of Convenience and Necessity ("CC&N") approved for that purpose by the Commission in Decision No. 66101 dated July 25, 2003.

The Staff Report finds SemStream Arizona to be a fit and proper entity to acquire the assets of the BMG Page Division propane system and concludes that the transaction is in the public interest. Moreover, Staff finds that the acquisition is consistent with the intent of Commission Decision No. 66101 ordering Southwest to divest the BMG Page Division. Staff therefore recommends approval of the Joint Application filed on October 31, 2006 (the "Application") to transfer BMG's regulated assets and CC&N related to the Page Division to SemStream Arizona, subject to several proposed conditions. In this response, the Applicants seek to clarify several factual matters and comment on Staff's recommended conditions.

II. FACTUAL CLARIFICATIONS

To ensure the accuracy of the record on this matter, Semstream Arizona notes the following clarifications to the Staff Report:

- 1) In the fifth sentence of the third paragraph of the Background section, page 1, it should be clarified that SemStream, L.P. owns and leases in excess of 10 million gallons of physical storage.
- 2) In the tenth sentence of the Background section, beginning on page 1 and carrying over to page 2 of the Staff Report, it should be clarified that SemStream, L.P.'s management team

has extensive experience in the natural gas liquids industry, as opposed to the "gas industry" as stated in the Staff Report.

III. RESPONSE TO STAFF'S RECOMMENDED CONDITIONS

At pages 6-8 of the Staff Report, Staff recommends that the Commission approve the Joint Application subject to sixteen (16) conditions. For the most part, the Applicants believe the recommended conditions are reasonable and take few exceptions. The Applicants are prepared to accept Staff's recommended Condition Nos. 1 through 4; 7 through 14; and 16 without amendment. However, SemStream Arizona objects to Staff's recommended conditions pertaining to acquisition costs and adjustment (Condition Nos. 5-6) and also proposes a minor amendment to Condition No. 15.

A. Exception to Recommended Condition Nos. 5 and 6

In Condition Nos. 5 and 6, Staff recommends that "SemStream Arizona shall not seek regulatory recovery of any costs arising from this transaction in a future rate proceeding" and that "the Commission deny SemStream Arizona recovery of any acquisition adjustment resulting from this transaction." In the alternative, Staff recommends in Condition No. 7:

That if the Commission decide[s] to defer consideration of regulatory recovery of acquisition costs and acquisition adjustment in a future proceeding, that SemStream Arizona be required to "demonstrate that clear, quantifiable and substantial net benefits to ratepayers have resulted from the acquisition of the Page Division's systems that would not have been realized had the transaction not occurred, before the Commission would consider recovery of any acquisition adjustment in a future rate proceeding."

In the event that an acquisition adjustment appears to be justified after SemStream Arizona is permitted to operate the Page Division, then adoption of Condition No. 7 is more consistent with the Commission's findings and orders in Southwest's initial acquisition of BMG in 2003 (Docket Nos. G-01551A-02-0425; G-01970A-02-0425) and reiterated in the decision reached by the Commission during its March 13, 2007 Open Meeting in the matter of SemStream Arizona's acquisition of the Payson-area propane system previously operated by Energy West

(Docket Nos. G-20471A-06-0515; G-02696A-06-0515). Conditions 5 and 6 are not consistent with the Commission's position rejecting a similar Staff proposed condition in connection with Southwest's acquisition of BMG in 2003. In its Decision No. 66101 – a direct precursor to the present proceedings – the Commission found as follows:

We recognize that Staff's position is premised on Staff's belief that it is in the public interest to protect ratepayers from bearing the costs of the transaction in the absence of a showing of significant benefit to consumers. However, we do not believe it is in the public interest to make a final decision on these issues without having all relevant information before us. Until SWG is able to operate the BMG system, we do not know if there will be significant efficiencies that would warrant recovery [of] a portion of the acquisition premium from ratepayers. We do not want to foreclose SWG from being able to bring forth evidence of significant improved efficiencies from acquisitions. To do so might discourage transactions that would benefit the public.

(Decision No. 66101, July 25, 2003, page 13, lines 20-27.)¹ The Commission reiterated this position when it adopted the Recommended Opinion and Order in the SemStream Arizona-Energy West matter on March 13, 2007. Although this issue was a topic of discussion among the Commissioners during their deliberations on March 13, 2007, it was ultimately decided that, since SemStream Arizona would retain the burden of proving that a cost recovery or adjustment could be justified in a later rate proceeding, it was not necessary to preclude SemStream Arizona from having the opportunity to assert its case at a later time.

As found by the Commission in these decisions, a condition automatically prohibiting future cost recovery is not in the public interest if it might act to discourage transactions that could produce net consumer benefits or if it counteracts the incentive for regulated companies to strive toward peak efficiency and denies an acquiring utility the opportunity to establish and demonstrate operational and administrative efficiencies and consumer benefits justifying an acquisition adjustment in a later, publicly noticed rate proceeding. Nothing in these Commission decisions suggests that the acquiring utility shall be automatically entitled to cost recovery, but

¹ For the Commission's convenience, the relevant pages of Decision No. 66101, dated July 25, 2003.

this does not equate to an automatic denial, as would be the effect of adopting Staff's Recommended Condition Nos. 5 and 6.

Staff finds SemStream Arizona to be a suitable buyer and concludes "that this transaction could positively impact ratepayers, in terms of propane price stability, supply security, and quality of service." Staff Report, page 3. Imposing Staff's Recommended Condition Nos. 5 and 6 on SemStream Arizona would be contrary to the public interest and otherwise counterproductive. For these reasons, SemStream requests the Commission approve the transfer of the Page Division assets without imposing Staff's Recommended Condition Nos. 5 and 6 and instead adopt Staff's alternative Condition No. 7.

B. Requested Amendment To Recommended Condition No 15

Condition No 15: In Recommended Condition No. 15, Staff proposes to require "[t]hat SemStream Arizona upgrades the existing manuals to more correctly reflect Page Division's operation within 30 days after the completion of sale." SemStream Arizona does not object to the proposed requirement that it upgrade the existing manuals for the BMG Page Division. However, SemStream Arizona believes the requested 30-day timeframe is insufficient. SemStream Arizona and BMG's mutual goal is to provide for as smooth a transition as possible for Page Division employees and customers alike. Before it can accurately update the manuals, SemStream Arizona must be in position to operate the Page Division propane system for more than a few days. There also may be opportunities to improve operation of the system that will become apparent only after SemStream Arizona takes over the system, assuming the Application is approved. SemStream Arizona requests that Staff's Recommended Condition No. 15 be amended to provide for six months after completion of the sale for SemStream Arizona to upgrade the existing manuals to more correctly reflect the Page Division's operation.

IV. CONCLUSION

The Applicants appreciate the efforts made by Staff in its review and expeditious processing for this Joint Application. SemStream Arizona and BMG request that the Commission

enter its Order approving the Joint Application subject to the Staff Report's Condition Nos. 1 through 4 and 7 through 16, with the requested amendment to Condition No. 15 identified above. For the benefit of Page Division customers and employees, it is important that the Applicants be permitted to close the transaction as soon as possible so that SemStream Arizona can commence the planning, procurement, supply and other operational arrangements for the next winter season, a process that normally begins in March. For that reason, the Applicants request the Recommended Opinion and Order be prepared in time for this matter to be decided at the Commission's May 2007 Open Meeting, or, if at all possible, in time for the April 2007 Open Meeting. To assist in that regard, the Applicants will order an expedited transcript of the March 26 hearing and are agreeable to abide by a five-day exception period in place of the ten-day exception period under A.A.C. R14-3-110.B.

The Applicants look forward to a prompt approval of the Joint Application so that SemStream Arizona can begin serving the propane needs of the Page area customers.

DECISION NO. 66101

EXCERPTS

BEFORE THE ARIZONA CORPORATION COMMISSION
Arizona Corporation Commission

COMMISSIONERS

DOCKETED

JUL 25 2003

MARC SPITZER, Chairman
JIM IRVIN
WILLIAM A. MUNDELL
JEFF HATCH-MILLER
MIKE GLEASON

DOCKETED BY

Nae

IN THE MATTER OF THE APPLICATION OF
SOUTHWEST GAS CORPORATION FOR
APPROVAL OF ACQUISITION PLAN AND, IF
APPROPRIATE, WAIVER OF SELECTED
PROVISION OF THE AFFILIATE RULES.

DOCKET NO. G-01551A-02-0425

DOCKET NO. G-01970A-02-0425

DECISION NO. 66101

OPINION AND ORDER

DATE OF HEARING:

February 24, 2003 and March 3, 2003

PLACE OF HEARING:

Phoenix, Arizona

ADMINISTRATIVE LAW JUDGE:

Jane L. Rodda

APPEARANCES:

Mr. Andrew Bettwy, Attorney, on behalf of
Southwest Gas Corporation;

Mr. Timothy Berg, Fennemore Craig, on behalf
of Black Mountain Gas;

Mr. Daniel Pozefsky, Attorney, on behalf of the
Residential Utility Consumer Office;

Mr. Walter Meek, President, Arizona Utility
Investors Association; and

Ms. Lisa Vandenberg and Jason Gellman, Staff
Attorneys, Legal Division, on behalf of the
Utilities Division of the Arizona Corporation
Commission.

BY THE COMMISSION:

Southwest Gas Corporation ("SWG") is a public service corporation that is engaged in the business of purchasing, transporting and distributing natural gas in portions of Arizona, Nevada and California. SWG serves over 800,000 customers in Arizona, a rapidly growing service territory that adds approximately 30,000 new customers per year. In 2001, SWG had total assets of \$2.3 billion, generated revenues of \$1.4 billion and earned a net income of \$37 million.

Black Mountain Gas Company ("BMG") is a public service corporation that provides retail

1 convenience and necessity require." A.R.S. § 40-282 permits the Commission to attach conditions to
2 a CC&N that are necessary to promote the public interest.

3 The Commission must consider all of relevant standards in considering whether to approve
4 this transaction. The public interest includes the safety and adequacy of service certainly, but also
5 involves the impact of disparate rates, the reasonableness of those rates, the impact of Commission
6 policy on utility operations in the state, advancement of Commission policy goals and legal
7 precedent, as well as other factors. The Commission has the authority to impose conditions on the
8 transaction that mitigate potential harm to the public interest or which may be required by the public
9 necessity and convenience, as those interests are broadly defined. We believe that although Staff
10 couches its recommendations in terms of providing an immediate and substantial consumer benefit
11 which some parties have interpreted as creating a novel standard for reviewing acquisitions, in fact,
12 we find many of Staff's recommendations are terms and conditions required by the public
13 convenience and necessity or to prevent harm to the public interest.

14 Acquisition Adjustment and Cost of Acquisition

15 Conditions Nos. 1 and 2

16 Staff recommends that the Commission preclude SWG from seeking recovery of the
17 acquisition premium paid for BMG and from recovering the costs of the acquisition in its next rate
18 case. All other parties advocate deferring a decision on these issues until the next rate case when
19 SWG will have an opportunity to provide evidence that might support such recovery.

20 We recognize that Staff's position is premised on Staff's belief that it is in the public interest
21 to protect ratepayers from bearing the costs of the transaction in the absence of a showing of
22 significant benefit to consumers. However, we do not believe it is in the public interest to make a
23 final decision on these issues without having all relevant information before us. Until SWG is able to
24 operate the BMG system, we do not know if there will be significant efficiencies that would warrant
25 recovery a portion of the acquisition premium from ratepayers. We do not want to foreclose SWG
26 from being able to bring forth evidence of significant improved efficiencies from acquisitions. To do
27 so might discourage transactions that would benefit the public. Our decision here does not mean that
28 ratepayers should or will bear any portion of the costs associated with this acquisition, only that when

1 the relevant information becomes available, SWG should have an opportunity to show sufficient
2 consumer benefits to justify recovery of the acquisition premium or other costs from ratepayers.
3 SWG will bear the burden of proving clear and quantifiable savings for all ratepayers directly related
4 to the acquisition and SWG's management/operation of the BMG system.

5 SWG's Rates
6 Condition No. 5

7 The most contentious of Staff's proposed conditions is the requirement that SWG charge its
8 margin rates in the BMG service area by July 1, 2004, or file a rate case. Staff believed that because
9 SWG did not adequately address Staff's questions about future benefits to BMG consumers and
10 concerns about maintaining service and safety quality in the BMG area, that SWG should provide an
11 immediate and substantial consumer benefit in the form of lower margin rates. Staff also argued that
12 it is potentially confusing and not in the public interest for neighboring SWG and BMG consumers to
13 pay different rates.

14 SWG's approach to wait to adjust the BMG customers' rates until the next SWG (as yet
15 unscheduled) rate case ignores its own arguments in favor of the transaction. SWG will begin
16 integrating the BMG operations into its own as soon as the Commission approves the acquisition.
17 Such integration will alter the very basis of BMG's current rates which were set based upon that
18 company's rate base, operating costs and return on capital. It is not in the public interest for BMG
19 customers to pay unreasonable rates. Neither do we believe having neighboring customers pay
20 different rates to be in the public interest.

21 We find that it is not in the public interest for current BMG customers to continue to pay the
22 higher BMG margin rates after July 1, 2004. Once the current assets and CC&N are transferred to
23 SWG, and BMG is dissolved, the customers of BMG become customers of SWG. At that point,
24 BMG ceases to exist as a public service corporation and there is no reason to differentiate one SWG
25 customer from another. SWG has not provided evidence that in this case it is reasonable for it to
26 continue charging the rates of a dissolved public service corporation once the acquisition and
27 integration is complete.

28 The Scates and Rio Verde cases cited by opponents in support of the contention the